BEITEN
BURKHARDT

LITHUANIA

Mantas Petkevičius
Partner
Soranien
44A Gedimino Ave I LT-01110 Vilnius
+370 52 685 040
mantas.petkevicius@sorainen.com

Povilas Užkuraitis
Lawyer
Soranien
44A Gedimino Ave I LT-01110 Vilnius
+370 52 685 040
povilas.uzkuraitis@sorainen.com

Q&A

Please provide a brief overview on how an ESOP in a start-up is usually structured in your jurisdiction (of particular interest: virtual or real participation programs, market practice with regard to vesting, participation (exits, proceeds and dividends) and voting rights).

Structure. Lithuanian startups usually structure ESOP via:

- Agreement among the shareholders (via Shareholders Agreement, shareholders res-olution or, sometimes, board's decision) regarding the size of ESOP (i.e. percentage of the share capital that could be distributed to employees) and, sometimes, main terms of the options; and

- Direct Share Option Agreements between the startup and the employee (option holder) re-garding specific rules and terms of the option.

Plan vs agreement. Although, it is possible to conclude the share option plan and some startups do have them, usually, no share option plans are concluded (but rather direct agree-ments between the startup and the employee).

Shares vs phantom units. Employees usually receive the right to acquire actual shares (and not a phantom or some other profit-related unit or cash), which is highly reasoned by the tax

reliefs described below (where the tax relief is applicable only when an employee acquire actual shares under option agreement). However, it is rather popular to state in the agreements that the option is exercisa-ble only immediately prior the change of control, meaning that although the employee would receive the actual shares for some moments, such employee would probably have an obligation to sell all of them during the change of control event. Therefore, at the end of the day, such options are similar to phantom units, although legally they are structured differently.

Vesting. General market practice is to have 4-year monthly vesting with 1-year cliff period. Some other startups also have 3-year vesting (but not shorter, again – due to the tax relief described below, and almost none or only a very few have 5-year or longer vesting), some of them also do not have cliff periods.

Exercise. Exercise of the option is either linked to (i) end of vesting period (3-4 years), or (ii) with the change of control of the startup (and accelerate, if change of control happens earlier than the vesting ends).

Exits. There were not too many successful exits from the Lithuanian startups yet (although they are coming soon), but from the ones that have already took place (and also based on the conditions of the option agreements of the startups that have not had the exit yet), it is the usual practice that the employees convert the options immediately prior the exit and then sell the shares together with all shareholders, where their would receive pro rata proceeds with the founders, after all investors or other shareholders with liquidation preferences receive their preferential proceeds.

Please provide an overview of the respective tax situation an employee finds him-/herself in when he/she participates in a real/virtual equity investment program (applicable taxes and approximate tax burden (a) at the time of the investment and (b) at the time when revenues therefrom are received).

Under a general rule, tax laws treat the benefit from share options as salary payments made in kind which are subject to payroll taxes:

- to 20 or 32% Personal income tax (PIT), where the higher 32% rate will start to apply on the yearly employment related income amount exceeding the established threshold. Currently, the threshold is 60 times the state average monthly salary amount (in total EUR 81 162); and

- to 19,5% - 22,5% Social insurance contributions (SIC) (depending on the accrual to additional pension), and 1,77% (or 2,49% in case of a fixed-term employment contract) on the top of the gross salary payable by the employer. SIC does not have to be withheld and paid from the amounts above the "SIC cap". The SIC cap corresponds to the same EUR 81 162 thresh-old at which the higher 32% PIT rate becomes applicable. This means that when the salary of the employee will exceed the threshold.

SIC does not have to be withheld and paid from the amounts above the "SIC cap". The SIC

cap corresponds to the same EUR 81 162 threshold at which the higher 32% PIT rate becomes applicable. This means that when the salary of the employee will exceed the threshold:

• the exceeding part will no longer be subject to 12,52% - 15,52% SIC (depending on the ac-crual for additional pension); and

• the company will also no longer be obliged to calculate 1,77% (2,49%) SIC from the limit-exceeding salary of the employee.

It should be noted, however, that the “SIC cap” is not applicable to the remaining 6.98%, which must nevertheless, be deducted from employment related income amounts above the "cap". Either way the employee herself will have no additional tax obligations in terms of SIC payment or reporting

Whereas, a benefit from employees’ share options (difference between the market price and the purchase price of the shares) may be PIT exempt if the following conditions are fulfilled:

• ESOP is granted to an employee (but not exercised, i.e. shares are not received by an em-ployee) for at least 3 years; and

• ESOP agreement is concluded after 1 February 2020;

• employee will get benefit from ESOP in a form of shares (type of the shares is not specified in the Law on PIT);

• according to the provisions of the ESOP agreement employees should have a right to opt acquiring the shares or to refuse from them. As the said tax exemption applies to “share op-tion agreements”, aspect of having an option to choose getting shares during exercise or not should be established.

This incentive allows postponing the payment of PIT to the moment, when the employee earns money from the sale of the shares acquired by way of exercising the share option. Moreover, this incentive should also effectively reduce the tax burden, as capital gain received from the sale of shares is taxed with 15-20*% PIT (*when threshold exceeds 120 country average sal-aries (approx. EUR 162,324 in 2021)) whereas rate of applicable PIT on the salary is 20-32%. This tax incentive applies in case the shares are received either from the employer or from a person related to the employer (for instance, parent company).

Similar tax incentive is applicable with respect to SIC. Income in kind benefits from share op-tions are exempt from SIC if the share option is granted to the employee and is exercised (the shares are acquired) not earlier than 3 years from grant of the stock option.

Are there any tax advantages for an employee if the revenues based on the equity in-vestment are reinvested in start-ups or other companies?

No. There is tax incentive only for exercising share options after 3 years from grant.

Reinvesting proceeds fall under general tax treatment.

Are there any tax advantages for the company if an ESOP is established in the company?

Yes. The PIT relief on stock options applies if the conditions of the stock option are met regardless of whether the stock option was granted by the employer or a person related to the employer. However, the SIC relief on stock options only applies if the option was granted only by the employer and provide actual shares through exercising of these share options after 3 years has passed from grant. Therefore, the company as employer could use the SIC relief on stock option.

Please highlight one pro and one con of the legal set up with regard to ESOPs in your jurisdic-tion.

Pro: full payroll taxation exemption available for ESOP if exercise is after 3 years from grant, while PIT on capital gains depend on the tax residency of the employee.

Con: the PIT relief on stock option is applicable only if the employee is still working for the company at the time of the exercise of the option, i.e. employment relationship is not terminated.